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STATE PASS TO FEDERAL RESERVE (CARLOS ARTETA)  
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SUBJECT: MEXICO ECONOMIC NOTES, APRIL 27 - MAY 4

Summary  
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11. (SBU) The Mexican senate approved a bill combating terrorist financing that will now go to the President for signature. The Bank of Mexico (BOM) raised interest rates by a quarter percent to head off inflation, and the Finance Secretariat and BOM revised this year's growth forecast

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downwards. Mexican economic leaders met to call for change in the wake of yet another study showing dropping Mexican competitiveness. GOM officials pledged to better protect copyrights, trademarks, and patents after reappearing on the "USTR Special 301 IPR Watch List." Both Standards and Poors and Fitch Ratings assigned their highest ratings to the State of Hidalgo newest financing vehicle after the state received USAID technical assistance in the field. Finance Secretary Carstens, in a meeting with congressional representatives, confirmed that Congress would have a fiscal reform package to consider before September. End summary.

Terrorist Financing Bill Passes Congress  
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12. (SBU) Mexico's Senate passed a bill on April 26 that would punish people who finance terrorist groups with up to 40 years in prison (See Mexico 963). The measure passed over the PRD's opposition to what they called vague wording defining terrorism that could be used against legitimate political activity. The bill would establish terrorism financing and international terrorism as serious criminal offenses, as called for in UN Resolution 1373, and also would make it easier for police to investigate bank records in cases of suspected terrorism. The Chamber of Deputies (lower house) approved the bill on February 20, 2007. To become law, the bill must be signed by the President and published in the official gazette.

## BOM Raises Interest Rates

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¶3. (U) The Bank of Mexico (BOM) caught many economists off guard on April 27 when it decided to raise its benchmark interest rate from 7.0% to 7.25% to head off the threat of inflation. All 16 economists surveyed by Bloomberg had expected the BOM to hold rates steady after consumer prices fell in the first half of April, bringing headline inflation down to 3.96%, below the BOM's 4% upper limit. Most analysts believe that this is not the beginning of a tightening cycle, but rather a move intended to keep hikes in food prices from spreading to other areas of the economy and, as some note, a move to help restore the BOM's credibility. The Finance Secretariat this week revised its growth forecast for 2007

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from 3.6% to 3.3%, and the central bank lowered its forecast to 3.0-3.5%. Unemployment rose from 3.5 to 4.0 percent in the first four months of the Calderon presidency according to the Mexican National Statistics Institute. Observers noted that both the formal and the informal sector, which can act as a "safety valve," are weakening.

## Economic Leaders Call for Action on Competitiveness

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¶4. (U) Secretary of Economy, Eduardo Sojo; Senate Competitiveness Chair Eloy Cantu Segovia; Chamber of Deputies Competitiveness Chair, Mariano Gonzalez Zarur; and Roberto Newell of the Mexican Competitiveness Institute (IMCO) spoke together on the need to immediately address Mexico's grave competitiveness problems. By IMCO's own analysis, Mexico dropped from 30th to 33rd place among the world's 45 largest economies in terms of its competitiveness. The conference's message was that the decision time is now and that Chile, Ireland, and South Korea were able to turn their economies

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around with sensible and sustainable policies. Mexico can do it too. All participants received a large tome describing Mexico's shortcomings with respect to other nations that have done better in many global/sectoral rankings during 2006. OECD Secretary General Jose Angel Gurria spoke to the audience by video link from Paris and echoed others' comments that Mexico faces "very serious" competitiveness problems. The OECD plans its economic review of Mexico to help set the stage for needed economic policy actions. Review recommendations include (1) promoting free competition in the economy (code words for taking on monopolies and oligopolies); (2) ensuring a high-quality and effective regulatory structure; and (3) promoting more effective government (good governance/rule of law/combating corruption).

## Mexico Will Do Better on IPR

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¶5. (SBU) GOM officials responded positively to news that Mexico will stay on USTR's Special 301 IPR Watch List, expressing their commitment to take measures both domestically and in coordination with the U.S. to better protect copyrights, trademarks, and patents. In recent weeks there have been encouraging signs of progress. President Calderon reiterated in an April 26 speech his government's determination to combat piracy. The Mexican Senate passed a bill that would give law enforcement officials ex officio authority to go after pirates and counterfeiters. The Chamber of Deputies is expected to pass the bill into law in September. Mexico's Office of the Prosecutor General of the Republic (PGR - equivalent of U.S. Department of Justice) has finished staffing its IPR team and is set to launch an interactive IPR website. Mexico also asked to join as a third party the consultations the U.S. requested with China regarding its failure to honor its WTO commitments with regard to IPR protection. The upcoming visit of Commerce

Under Secretary Lavin and the meeting of the SPP working group on IPR scheduled for next month provide opportunities to recognize these advances and push for further progress. For more details, see septel.

#### State Public Finance Success

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¶6. (SBU) USAID's program to help Mexico's states and municipalities tap innovative sources of financing had a major success when both Standards and Poors and Fitch Ratings assigned their highest ratings (AAA.Mx) to the Hidalgo financing vehicle that is comparable to a state revolving fund. The State of Hidalgo received technical assistance through USAID's Global Development Alliance partner, Evensen Dodge International. This is the first state revolving fund to receive the highest domestic rating in Mexico, AAA.Mx. It will permit the State of Hidalgo to access capital market financing at preferential rates, which will benefit Hidalgo itself, and allow 84 underlying municipalities and parastatal entities to access private financing through this revolving fund. The fund will issue 2,387,000,000 Mexican pesos (USD 221 million) to refinance and restructure outstanding debt. The deal is in final negotiations and is expected to close on May 8.

#### Fiscal Reform Coming This Summer

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¶7. (U) Finance Secretary Augustin Carstens in a meeting with congressional representatives, confirmed that congress would have a fiscal reform package to consider before September when the session reopens, but no decision has been taken as to whether the package would include controversial provisions extending value added tax to food and medicine. PRD and PRI members have signaled that any proposal including such a tax

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would fail. President Calderon outlined the "four pillars" of the reform proposal as (1) improve transparency and accountability in government spending and gear more expenditures towards socioeconomic development; (2) diversify sources of government income to reduce vulnerability of the federal budget to changes in the oil price; (3) re-establish "on a firm basis" the financial relationship between the federal government and the states; and (4) improve tax collection efficiency, with the goal of increasing collections by 3 percent of GDP during the Calderon sexenio.

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